



Dan Bucks  
Director

# Montana Department of Revenue



Brian Schweitzer  
Governor

EXHIBIT 6  
DATE 1.24.07  
HB 108

## MEMORANDUM

TO: Representative Bob Lake  
FROM: Dave Hunter, Deputy Director  
DATE: January 23, 2007  
SUBJECT: HB108

### **HB108 – Conform State Withholding Provisions to Federal Withholding Provisions for Pensions, Annuities and certain other Deferred Income**

#### **Issues Raised by Opponents of the Bill**

Jacqueline Lenmark – American Council of Life Insurers

#### **Issue 1:**

**Ms. Lenmark:** New Section, Section 1, subsection 1 of this legislation refers to periodic and nonperiodic payments as defined in section 3405 of the Internal Revenue Code. Although periodic payments are defined in federal statute, there is no definition for nonperiodic payments. This causes confusion, nonperiodic payments should be defined.

**Department Response:** Upon review of Section 3405 of the Internal Revenue Code we would agree with Ms. Lenmark that the term “nonperiodic payment” does not seem to be defined. The term most consistently used and defined in the IRS code is “nonperiodic distribution”. We would recommend changing our language in HB108 to refer to nonperiodic distributions and remove the references to nonperiodic payments. Please refer to our recommended amendments.

**Issue 2:**

**Ms. Lenmark:** New Section, Section 1, subsection 2, refers to "designated distribution". Although this term is defined in federal law, there is no definition in state law. Designated distribution should be defined in state law.

**Department Response:** "Designated distribution is clearly defined under section 3405(e) of the Internal Revenue Code. In general the term "designated distribution" means any distribution or payment from or under: an employer deferred compensation plan, an individual retirement plan (as defined in section 7701(a)(37)), or a commercial annuity.

The intent of HB108 is to conform the state's withholding provisions to the federal holding provisions. We believe that the federal definition is consistent with the intent of HB108 and clearly applies to this legislation.

**Issue 3:**

**Ms. Lenmark:** New Section, Section 1, subsection 2 states that "a designated distribution must be treated as if it "was" wages paid. Federal statute states shall be treated as if it "were" wages. Was implies that they are wages, were refers to "in the same manner" as wages. Although this may seem inconsequential, it means that the distribution is treated in a similar manner. This could present problem for tax preparers. We believe that "were" is the appropriate word here.

**Department Response:** We agree with Ms. Lenmark's concern and suggestion. We would recommend changing the language in HB108 to use the word "were" instead of the word was in the appropriate section(s) of our bill. Please refer to Section 1, subsection (3) of our recommended revised version of HB108 attached.

**Issue 4:**

**Ms. Lenmark:** New Section 1, subsection 2, the amount of withholding is subject to Montana law under 15-30-202 which refers to tax tables and doesn't allow for an arbitrary (lump sum?) amount, setting up a conflict between existing law and proposed law.

**Department Response:** To address Ms. Lenmark's concerns and issues with this section of HB108 the department recommends amended language to HB108 which we believe clarifies what we are trying to accomplish in this section. We are simply trying to say that if an individual has federal withholding they also will have state withholding equal to 30% of the federal rate. The amount of money withheld for state withholding will be treated as if the monies were withheld from wages and will be subject to the withholding provisions specified under 15-30-202, MCA. Please refer to New Section, Section 1, subsection (3) of our recommended amendments to HB108. Please refer to our recommended amendments.

**Issue 5:**

**Ms. Lenmark:** New Section 1, subsection 2, states that a designated distribution must be treated as wages. Is this correct language or should it say "income" instead of wages?

**Department Response:** No, we believe that "wages" is the appropriate language here. This section of the bill requires all monies withheld to be treated as if the monies were withheld from "wages" paid by an employer to an employee subject to withholding under 15-30-202, MCA. This is language taken directly from the statute. The department's withholding tables pertaining to the section of law are tied to wages to accommodate the statutory provisions of 15-30-202. We hope that our recommended amendments contained in subsection (3) of New Section, Section 1 of HB108 clarify this issue and address Ms. Lenmark's concerns.

**Issue 6:**

**Ms. Lenmark:** In the IRS code, designated distributions is defined as commercial annuities and other definitions, wonder whether the bill sweeps insurance and annuities into the bill along with pensions and retirement accounts?

**Department Response:** Yes it does. If they are subject to withholding at the federal level and have federal withholding they would have state withholding also.

**Unanswered Questions from Committee Members:**

**Representative Sonju**

What are "other deferred incomes"?

**Department Response:** The instructions contained in the IRS Form W-4P associated with the withholding of pension and annuity payments states: "Generally, federal income tax withholding applies to the taxable part of payments made for pensions, profit-sharing, stock bonus, annuity, and certain deferred compensation plans; from individual retirement arrangements (IRAs); and from commercial annuities." Based on this definition we believe "other deferred income" would include profit-sharing and stock bonuses as described in definition. Under the bill, Montana's withholding on this income would strictly follow the federal withholding practice.

**Chairman, Representative Lake**

Are there any threshold amounts at the federal level below which no withholding would occur?

**Department Response:** For periodic pension and annuity payments, a taxpayer can file a W-4P with their filing status (married, single, etc.) and number of exemptions for each pension and annuity payment they receive. The federal withholding amount is then based on the same tables used for wages. If a taxpayer does not submit a W-4P, the federal law requires withholding on the taxpayer as though they are married and have 3 exemptions. Based on current federal tables, a taxpayer would have to receive at least \$1,520 per month from that pension or annuity before any withholding would occur. Because HB108 bases any potential state withholding on the federal withholding amount, there wouldn't be any state withholding either.

For the other payments and distributions covered by HB108, there are no thresholds at the federal level.

The state's withholding schedules are specifically identified under 15-30-203 through 205 and 15-30-241. These schedules establish monthly payments, accelerated payments, or annual payments, dependant upon the amount of tax monies withheld. There are also annual reporting requirements under 15-30-206 and 207. An annual withholding statement is required to be sent to the employee prior to January 31 in each year under 15-30-206 showing the amount of federal and state income tax deducted and withheld and the tax deducted and withheld there from under the provisions of 15-30-201 through 15-30-209. An annual statement, under the provisions of 15-30-207, is also required to be sent to the department on or before February 28 in each year showing this information.

**Additional Department Comment:**

We would like to point out to the committee that this legislation is not a new concept. According to our research there are a number of other states that have state withholding provisions for pensions, annuities and certain other deferred income that are tied to federal withholding provisions. The states we are aware of are California, Oregon, North Carolina, Virginia, Oklahoma, Nebraska, Illinois, Arkansas, Indiana, and Massachusetts. There may be other states as well. Given this pattern of existing state laws spread across the nation, it is unlikely that any major insurance, pension or financial firms will need to change any systems or procedures to accommodate this legislation.